



20044046E

DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: March 23, 2004

Contact Person:

Identification Number:

Contact Number:

UIL: 501.00-00

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section for the reasons set forth below.

1. Facts

(hereinafter) was incorporated in the state of on

Your stated purpose, as represented in your Articles of Incorporation, is "to provide credit counseling." On page 2 of your Application for Recognition of Exemption (Form 1023) (hereinafter "application"), you further explain that your "primary role is providing debt counseling service and education to clients who are struggling with their financial condition. The debt counseling program is designed to create a personalized solution for each client based on their individual needs. In addition, the organization will provide community services and education to local groups whose members can benefit from that education. Only the client's unsecured debt will be addressed." You further state that "after completing an application, a client will work directly with a certified counselor to determine a debt consolidation program that fits within their budget constraints. Our organization will then contact each of the client's creditors and negotiate the best possible plan for that client." Lastly, you state that "the organization will work closely with each client to provide support throughout the term of the debt counseling program, and encourage and educate the client to adopt more responsible credit habits in order to avoid a relapse into a negative financial situation." However, an information item appended to the Consolidation Services Agreement alerts your clients to the "dual role" that is reflected in fees you receive from two parties: assisting creditors in receiving money owed to them as well as assisting the client in reducing debt.

DR-068-2004

Your operations actually started under the name _____ (hereinafter _____ as a for-profit corporation under _____ state law. Within a few months you separated from _____ and incorporated under your present name, _____ as a non-profit corporation under _____ state law. _____ has continued in business. According to your application, your Board of Directors include: _____ (secretary-treasurer), _____ (vice-president), and _____ (president). In response to our letter of December 30, 2003, you stated that "each of the board members of _____ is a shareholder of _____ and there are _____ active members of the board of _____ who assist in the day to day operations of _____. There are no other shareholders of _____. _____ is a full-time employee of _____ working between _____ and _____ hours per week as its Chairman and CEO. _____ is the President and COO of _____ managing the counselors, client services, and accounting. He works approximately _____ to _____ hours per week. None of the _____ directors receive compensation from _____. According to your response to our letter dated August 27, 2003, "among the _____ members of the governing body, _____ of the members are related. _____ is the father-in-law of _____ is the son-in-law of _____ and cousin to _____ is cousin to _____ and _____ are controlled by the same individuals.

According to Article VIII of your Articles of Incorporation, "the Board of Directors shall be elected by the membership at each annual meeting of the members." Your Bylaws provide that "there shall be no members and Article III is hereby deleted." Your bylaws also provide some information about membership, and thus, there appear to be contradictory statements in your documents with respect to whether you actually have members. Thus, your Bylaws provide that, with no members, your existing Board of Directors is a self-perpetuating group.

In response to a question in our December 30, 2003, letter, regarding the addresses of _____ and _____ you stated, _____ is a for-profit _____ corporation located in an adjacent office to _____. The address of _____ is _____ and the address of _____ is _____ (emphasis as in your letter) This statement is contradicted by many prior statements made by you and in documents submitted by you, all of which indicate that _____ and _____ operate out of the same office, _____. These documents include your application, your Counselor Training Manual cover sheet, your business license from the _____ and the Consolidation Services Agreement. In fact, on your business license with the _____ in the _____ there is a statement that says "credit counseling sharing space with _____

You provided information indicating that a Shareholders' Agreement was entered into between _____ and _____ and _____ as the sole shareholders of _____. The agreement stated that these four individuals "have invested in _____ in operating capital needed to start the business in the following percentages, _____ percent, _____ percent, _____ percent, and _____ percent." That agreement also enables these officers and directors of _____ to exercise redemptions of _____ stock at a price calculated using net profits and years in operation.

The shareholder's agreement also created a line of credit from _____ of the shareholders to _____ may draw on the line of credit at any time up to \$ _____. Upon a request, the amount will be paid within five days in the following proportions:

% by

% by

% by

Interest is paid monthly at the rate of _____ % over prime, but that rate may change. Principal is repaid when _____ has a net profit for _____ consecutive months. The shareholders decide the amount of principal that should be repaid in each payment.

The information you have provided indicates that _____ performs all of the activities of _____ and _____ entered into a management agreement dated _____ which states that _____ is a corporation formed to manage the business and administrative matters required as part of the community services performed by _____. The entire substantive content of the two page agreement consists of the following:

1. **Responsibilities of ' _____** shall be responsible to provide the employees, office space, office equipment, computer hardware, computer software, and expertise necessary to carry on the business of _____ in the field of consumer credit counseling.
2. **Compensation.** _____ shall compensate _____ for its services on a monthly basis, in the amount of the actual cost of _____ to provide the services required by this agreement.
3. **Term.** This agreement shall be effective for a _____ month period. It may be cancelled by either party with _____ days written notice. It may be extended by written agreement, or by the parties continuing to provide and accept the services required by this agreement.

Thus, under the agreement, you have no employees of your own. All the individuals working on any of your activities are hired, trained, supervised and managed by _____. You have no office or equipment, no computers or computer software. In choosing _____ to manage your business and administrative affairs, you stated in response to our letter dated August 27, 2003, that "no other companies were contacted directly prior to entering into an agreement with _____".

The agreement does not contain any mechanisms for validating the cost charged by _____ nor does it set controls or limits on compensation. The agreement is also silent as to any mechanisms for _____ to dispute the amount of _____ costs. There is no requirement that an independent audit be conducted, nor that there be some other mandatory reporting function to ensure proper oversight of _____ by you.

In your letter dated September 11, 2003, you describe _____ "counseling process" as follows:

- Each client has initially filled out an application detailing all of their contact information and a listing of creditors that they would like to include in the counseling program. Upon receipt of the application, a Certified Financial Counselor contacts the client to review the application and determine whether the client can benefit from the program. Once this has been established, there are a number of steps that are taken with each client. A financial addendum or budget is completed, and all other pertinent information is entered into the computer system to determine the

client's monthly payment amount and approximate length of time on the program.
[References to attached documents omitted.]

- Each client is faxed our service agreement which details the allocation of up-front fees, in addition each counselor explains the process.
- Each Debt Management Plan and written action plan is created in our system, along with the agreement sent to each client.

Your response does not describe any education or counseling as part of the "counseling program," other than enrolling the client in your "program," which you state is a "debt management plan."

From the information you provided, it is clear that the debt management plan (DMP) appears to work in the following way, using _____ employees and equipment contracted from _____

You contact a person from purchased leads or through your website. You attempt to enroll the potential client in a DMP, in which the client agrees to enter into a "Consolidation Services Agreement." _____ calculates the monthly payment required to pay-off the creditors included in the plan. _____ adds "a monthly processing fee of approximately _____ % of your annual payments, prorated monthly or a minimum processing fee of _____ dollars" to payments being made to creditors. The Consolidation Services Agreement further explains that the "CLIENT'S first payment is made to _____ as a one-time fee equal to one month's payment to CLIENT'S creditors." _____ retains the entire first monthly payment (the upfront fee). Thus, for the first month the client is in the DMP, his or her creditors receive no payment on debts. The client is required to pay the up-front fee before he or she receives any services.

If the client completes the program, which you anticipate taking _____ to _____ years, you will return part of the up-front payment to the client. You describe this in your client agreement as follows:

Upon completion of the program, CLIENT will be rewarded with a Cash Back Award based on all creditor obligations being satisfied. The Cash Back Award will be equal to CLIENT'S first monthly processing fee to DDI.

You have explained that the processing fee is _____ of _____ percent of the annual payments to all of a client's creditors, or a minimum of _____ dollars. Thus, if a client completes the program, the most he will get back is the one-twelfth of one percent processing fee. However, if the client does not complete the DMP program, he or she receives nothing.

Your Counselor Training Manual outlines how the counselors contracted from _____ interact with the creditors involved in the DMPs. When you receive the client's first payment and the creditor information is entered into the system, a proposal is sent to the creditor for the first time. The proposal asks the creditor to do the following: accept the payment amount, adjust the payment date, eliminate fees, lower or eliminate interest, contribute a fair share contribution, refrain from reporting a client as delinquent to the credit bureaus (once the proposal is accepted), and provide updated information regarding the creditor's account. According to this manual, you request that creditors reduce the interest rate. You also ask the creditors to stop charging the client late and over-limit fees. For _____ which consisted of _____ months of operation, _____ clients completed the debt management program, approximately _____ clients continued to participate in the program, and approximately _____ dropped out of the program.

Thus, in the first _____ months of operation, approximately _____ percent of the clients lost their up-front fees.

You have indicated you have two sources of revenue: (1) the up-front fees and monthly processing fees paid by your clients, and (2) the "fair share" payments made to you by the creditors receiving payments as a result of the DMPs. You do not anticipate any other source of receipts. You do not have a fundraising program to solicit voluntary contributions. According to your _____ and _____ budget projections, you anticipate receiving the following:

Year	Monthly contributions/fair share	Set-Up Fees
	\$ _____	\$ _____
	\$ _____	\$ _____

-All of your disbursements for _____ and _____ are expected to come from key expenditures for _____ compensated pursuant to the management agreement. These expenditures include: Legal/accounting/consulting, computer software (lease), insurance, loan repayment, interest, postage, office supplies, travel, training, telephone, rent, utilities, wages/taxes for counselors and administrators, and for advertising. One line item in the budget included with your letter of September 11, 2003 was a "loan repayment" expense to _____ in the amount of \$ _____. You have not provided information to show that it would not be used to pay off _____ debt to its shareholders, who are also your officers and directors. Moreover, the budget for advertising is \$ _____ for _____ and \$ _____ for _____. You state that your advertising practices are primarily organized to generate interest in your program and promote credit counseling through the Internet and the purchase of leads.

In response to the question, "Explain in detail how your organization's activities differ from that of _____," you stated, in your letter of September 11, 2003:

The agreement, made the _____ day of _____ by and between _____ and _____ [the management agreement], details how our organization's activities differ from that of _____ and explains how _____ is compensated. _____ activities differ from the operation of _____ primarily because of the community service and education programs that the organization is focused upon. While _____ remains dedicated to carrying on the daily operations of credit counseling, _____ focuses on the continued education of its Certified Financial Counselors, Clients, and the general public in understanding debt management and credit counseling. (See copy of Agreement between _____ and _____)

However, in response to our questions, you have not provided an explanation of information that appears to be inconsistent. You stated that "Community service is an integral part of the developmental phase of _____ which will allow us to perform workshops and seminars similar to the one at the _____ in _____. First, _____ has no employees; you have not described how it has the ability to carry on any community service or education programs on its own. Second, the Agreement you referenced contains no detail of _____ activities, other than the activity of paying _____ for services. Third, you have not described or provided any information regarding the community service or education programs that _____ performs by using

contracted employees. You have represented that, since your inception, you conducted one seminar that took place at a . You state that you discussed the benefits of your DMP to the and their families. We asked you in our letter dated December 30, 2003, to submit "copies of the agenda or material that was distributed at the class." We stated that, "if your workshops or seminars are still in the developing phase, then provide draft details." However, you only submitted a thank you letter and a Certificate of Commendation from the for work done at the compound. These documents are addressed to , and not to you. You failed to submit an agenda or any other written documentation with respect to the seminar. itself does not appear to have performed any community service, nor have you described how it has the ability to do so.

You submitted a Community Service Presentation as evidence of your community service. Much of this information is the same as that on your website as Lesson 1. See discussion of website below. This presentation includes statements such as,

The entire Presentation consists of similar material.

In response to our request for your educational materials, you provided a one page Counselor Presentation. You stated that the Counselor Presentation is the only script used when speaking with a potential client and only at the initial contact with a client. The only subject addressed in the script is a DMP:

You have not explained why you believe that the Counselor Presentation script relays educational information rather than markets the virtues of a debt management program to a potential client.

You further state that "a majority of our time and resources is spent educating our clients; however, most of this work is done over the telephone or one on one (in person) with clients with whom we are working." In describing how the counseling process works (see above) you have not provided any materials other than that concerning the process of enrolling clients in DMPs. Your Counselor Training Manual focuses on the creation and servicing of a DMP. On the first page of the Manual, you state "_____ educates its clients by explaining the intricacy of debt, the meaning of various credit terms, the various ways to pay debts, and the different internal policies of creditors. Clients are provided with guidelines and counseling pertaining to important information regarding debt and credit." The rest of the document describes activities for creating servicing DMPs. It discusses the following issues: (1) the proposal that is sent to the creditor for repayment to the client's debt; (2) answering the phone; (3) why creditors are still calling the consumer even after the consumer sent in his money; (4) the status of DMP accounts; (5) bill statements; and (6) payment receipts. There is no guidance given to the counselor in the Manual as to how to educate a client or counsel a client. In response to our questions you have not provided an explanation of how the rest of the Manual relates to the opening two sentences.

You have not provided an explanation of how meaningful counseling and education is being provided given the amount of time your counselors spend on the phone with clients and potential clients, and the methods used to reach potential clients. Information provided by you indicates that you will solicit clients for your debt management and credit counseling services through the purchase of leads. On your behalf, _____ purchases leads from _____ and _____ as well as from _____. According to your response to our letter of December 30, 2003 "these services provide names and contact information of individuals who have searched on the Internet for assistance with debt consolidation, credit repair, and financial planning." This contact information includes an e-mail address, home and work telephone numbers, preferred call time, requested loan amount, household monthly income, total debt (secured and unsecured), and current home value. Under the management agreement you entered into with _____ provides the leads to you for a per lead charge that is dependent upon the number of leads provided. The number of leads purchased by _____ (from other entities) and provided to you to date is approximately _____. The number of contacts who signed up for a DMP to date is approximately _____.

In response to our letter of December 30, 2003, you stated that "neither _____ nor _____ conducts any 'cold calling,' as all of the potential clients that we speak to have either completed an application or have been referred to us by another client." However, the evidence in the record is not consistent with your statement that you do not conduct "cold calling." The leads you purchased from _____ did not contact you. In your letter dated September 11, 2003, in which you describe the lead process, you state that, "...each client is contacted first to determine their level of interest in the benefits of credit counseling." You contacted the leads because you have information that these individuals applied for a loan or some other type of financial assistance from another entity. You further stated that "each potential client is called and sent an e-mail message based on the information that they provide on their application."

Each potential client is initially contacted to determine the individual's level of interest in the benefits of credit counseling. You describe a process of buying names and contact information from other entities to solicit those individuals to determine whether they would be interested in a DMP. The leads have expressed no previous interest in your services and are contacted by you in order to introduce your services.

In your response to our letter of December 30, 2003, you stated that "we make several attempts to contact a potential client and review his information, and then note the results of the call in our computer system. This is done to ensure that we are properly following up with each lead and to track any response from an individual that may have occurred after hours." You pay for many leads and repeatedly contact them in an effort to enroll a potential client in a DMP. You further stated that "Each employee may make up to approximately twenty calls per hour [or three minutes per call], depending upon the number of clients that are actually reached. If a counselor is enrolling a potential client in a DMP or reviewing budget information and providing counseling... the number of phone calls per hour drops to an average of ten calls per hour [or six minutes per call]." Once contact has been made and an individual expresses an interest in the program, he would complete an application detailing all of his contact and financial information, including a listing of his creditors. This constitutes a financial addendum or budget. All pertinent information is entered into the computer system to determine the individual's monthly payment amount and appropriate length of time on the program. Each DMP and written action plan is created in computer system, which is contracted out to you, along with an agreement that is sent to each client.

You also maintain that you provide counseling to individuals who do not qualify, are not interested in, or are exploring other options along with a DMP at no cost to the client. You further maintain that, of the individuals you contact, in approximately to percent of the cases, a counselor is working with a client who does not enroll in the program, with the remaining percent enrolling in a DMP. However, after reviewing all of your submissions, you have not explained how or to what extent the individuals who purchase DMPs, or those who do not purchase DMPs, receive any counseling and education during the limited time that you speak with them.

You have not established that your employees are trained to provide financial counseling. Only three of the certificates of training that you submitted even purported to cover financial counseling. You have not submitted any information to substantiate the credentials of the certifying institutions, nor any information on the curriculum that they provide. In your response to our letter of December 30, 2003, you state that you only "require that each employee used by to have a minimum of a high school diploma, and in most cases, some level of college or comparable degree." You also represent that "each such employee has a minimum of two years' experience in the industry." However, you failed to provide information on which employees have credit counseling experience, where they received that experience, and what that experience consisted of.

You represent that there are a total of counselors who provide financial and budgetary counseling as well as work on DMPs, and approximately counselors who provide only financial and budget counseling. Based on your submissions, you have not explained how the amount of time a counselor spends with each client includes significant, substantive counseling and education. You also maintain that all other employees provide support for those

clients already enrolled in the program, ranging from the processing of payments, client services, mailing, filing, creditors negotiations, and general office support. As indicated from your earlier submissions, this type of support is to ensure the proper administration of processing the DMPs. The total number of employees who provide support and client services is

In your response to our letter of December 30, 2002, you stated that "each day a counselor's time is divided into several different categories, but each counselor spends an average of four hours a day counseling clients that never enroll in the DMP. Two hours a day are spent working on personal budgets and reviewing client statements, and the remainder of their time is spent with those relatively few clients who enroll in the program." You further represent that "a majority of that remaining time is spent doing administrative work such as faxing, completing a client's file, collecting statements, and general follow-up telephone calls..." However, upon examination of information in your file, you have not explained how the "counseling" and "reviewing client statements" functions are different from the activity of contacting leads and determining whether individuals are eligible to enroll in a DMP.

You maintain that each counselor spends a minimum of 12 to 15 minutes determining a client's current budget, income, and the amount of debt they have. In there were no clients who paid the initial fee but did not enroll in the DMP. You state that, if and when a counselor has made a determination that a DMP is the proper direction for a client to take, it generally requires another 15 to 20 minutes to gather the necessary information from the client to enroll him in the program. You have not explained how this is evidenced by your submissions. In fact, these statements contradict your earlier representations that you make an average of 10 calls per hour (or 6 minutes per call) when a counselor is enrolling a potential client in a DMP or reviewing budget information.

You state in your response to our letter of December 30, 2003, that "each employee used by is paid a base salary and also participates in a bonus structure that was created to reward the entire group on retention of clients who enroll and remain in the debt management program. It is a percentage-based bonus program that is measured on a monthly basis by using the number of clients enrolled in the previous month and dividing it by the number of clients who make consecutive payments and stay on the program throughout the life of the consolidation." Your compensation structure takes into account activities to maintain and increase the numbers of clients enrolled in DMPs, but not activities providing substantive financial counseling or education.

On your application, you listed your Internet site address as however, after inspecting that site, we found that the site refers to as the provider of credit counseling and debt solutions, as stated in our December 30, 2003 letter to you. In the response to that letter, you state that you created a new Internet site, You maintain that potential clients and DMP clients have access to your website and constant support throughout the entire counseling experience. You also started a series of lessons on the website, a copy of which is enclosed. However, you have only included one lesson on the site, which contains a nine-page power point presentation. That presentation contains statements, such as

While these statements may be inspirational in nature for people in general, you have not explained how these statements provide in-depth substantive information and guidance on how to handle a financial crisis that may confront a particular individual or family. You have not explained how the very general references to money and credit contained in the slide show contribute to educating consumers about the sound use of consumer credit.

In a response to a question about making charitable donations to _____ you provided the following response. "Our intentions for charitable donations by _____ as proposed in our _____ and budgets are subject to available revenues, however, we have estimated approximately _____ % of our net profits to be dedicated to these organizations." You maintain that all of these organizations are recognized as exempt from federal income tax under section 501(c)(3).

2. Law

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) defines the words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations assigns the burden of proof to an applicant organization to show that it serves a public rather than a private interest and specifically that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the relief of the poor and distressed or of the under privileged as well as the advancement of education.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational" refers to:

- (a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
- (b) The instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business.

In Rev. Rul. 69-441, 1969-2 C.B. 115, the Service found that a nonprofit organization formed to help reduce personal bankruptcy by informing the public on personal money management and aiding low-income individuals and families with financial problems was exempt under section 501(c)(3) of the Code. Its Board of Directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

The organization provided information to the public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications. It aided low-income individuals and families who have financial problems by providing them with individual counseling, and if necessary, by establishing budget plans. Under the budget plan, the debtor voluntarily made fixed payments to the organization, holding the funds in a trust account and disbursing the funds on a partial payment basis to the creditors. The organization did not charge fees for counseling services or proration services. The debtor received full credit against his debts for all amounts paid. The organization did not make loans to debtors or negotiate loans on their behalf. Finally, the organization relied upon contributions, primarily from the creditors participating in the organization's budget plans, for its support.

The Service found that, by aiding low-income individuals and families who have financial problems and by providing, without charge, counseling and a means for the orderly discharge of indebtedness, the organization was relieving the poor and distressed. Moreover, by providing the public with information on budgeting, buying practices, and the sound use of consumer credit, the organization was instructing the public on subjects useful to the individual and

beneficial to the community. Thus, the organization was exempt from federal income tax under section 501(c)(3) of the Code.

Rev. Rul. 71-529, 1971-2 C.B. 234, held that a nonprofit organization providing assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualified for exemption under section 501(c)(3) of the Code. Most of the operating expenses of the organization, including the costs of the services of the investment counselors and the custodian banks, were paid for by grants from independent charitable organizations. The member organizations paid only a nominal fee for the services performed. These fees represented less than 15 percent of the total costs of the operation. By performing these services for a charge substantially below its cost, the organization was performing a charitable activity for purposes of section 501(c)(3) of the Code.

Rev. Rul. 72-369, 1972-2 C.B. 245, held that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under section 501(c)(3) of the Code. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services were provided at cost and solely for exempt organizations was not sufficient to characterize the activity as charitable for purposes of section 501(c)(3) of the Code. "Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable."

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purposes, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In American Institute for Economic Research v. United States, 302 F. 2d 934 (Ct. Cl. 1962), the Court considered an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and also services providing advice for purchases of individual securities. The court noted that education is a broad concept, and assumed *arguendo* that the organization had an educational purpose. However, it held that it had a significant non-exempt commercial purpose that was not incidental to the educational purpose, and therefore was not entitled to be regarded as exempt.

In Consumer Credit Counseling Service of Alabama, Inc. v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 1978), the court held an organization that provided free information on budgeting, buying practices, and the sound use of consumer credit qualified for exemption from income tax because its activities were charitable and educational.

The Consumer Credit Counseling Service, which has been recognized as exempt under section 501(c)(3), is an umbrella organization made up of numerous credit counseling service agencies. In this case, these agencies provided information to the general public through the use of speakers, films, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit. They also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. They did not limit these services to low-income individuals and families, but they provided such services free of charge.

As an adjunct to the counseling function, they offered a DMP. Only 12 percent of a professional counselor's time was applied to the DMP activity. The participants in the DMP received full credit against their debts for the amounts paid. Moreover, the agencies charged a nominal fee of up to \$ per month for the DMP. This fee was waived in instances when payment of the fee would work a financial hardship.

The agencies received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental amount of their revenue was from counseling fees. In 1974, the Service ruled that each of the agencies constituted organizations described in section 501(c)(3). However, two years later, the Service notified the agencies that it had made a mistake and was reclassifying them under section 501(c)(4). The reasons given by the Service for revocation of section 501(c)(3) were that: (1) the agencies were not organized and operated exclusively for charitable or educational purposes; (2) the debt management service is not limited to low-income individuals or families; and (3) fees are charged for the services rendered.

The court did not agree with the Service and directed verdicts for the plaintiff. Providing information regarding the sound use of consumer credit is charitable because it advances and promotes education and social welfare. These programs were also educational because they instructed the public on subjects useful to the individual and beneficial to the community. The counseling assistance programs were likewise charitable and educational in nature. Because the community education and counseling assistance programs were the agencies' primary activities, the agencies were organized and operated for charitable and educational purposes. The Court concluded that limited debt management and creditor intercession activities were an integral part of the agencies' counseling function, and thus were charitable and educational undertakings. Even if this were not the case, the Court indicated that these activities were incidental to the agencies' principal functions.

Finally, the court found that the law did not require that an organization must perform its exempt functions solely for the benefit of low-income individuals to qualify under section 501(c)(3). Nonetheless, the agencies did not charge a fee for the programs that constituted their principal activities. The court noted that a fee may be charged for a service that was an incidental part of an agency's function, but even when a fee was so charged, it was nominal. Moreover, even this nominal fee was waived when payment would work a financial hardship. Thus, the court ordered that "each of the plaintiff consumer credit counseling agencies was an organization described in section 501(c)(3) as a charitable and educational organization." See also, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979), in which the facts were virtually identical and the law was identical to those in Consumer Credit Counseling Centers of Alabama, Inc. v. United States discussed immediately above.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial. The court found that the corporation had completely failed to demonstrate that its services were not in competition with commercial businesses. The court found that the organization's financing did not resemble that of the

typical 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs, and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation had failed to limit its clientele to organizations that were section 501(c)(3) exempt organizations.

The court in est of Hawaii v. Commissioner, 71 T.C. 1067(1979) found that an organization formed to educate people in Hawaii in the theory and practice of "est" was a part of a "franchise system which is operated for private benefit," and therefore may not be recognized as exempt under section 501(c)(3) of the Code. The applicant for exempt status was not formally controlled by the same individuals controlling the for-profit organization owning the license to the est body of knowledge, publications, methods, etc. However, the for-profit exerted "considerable control" over the applicant's activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The court found that the fact that the applicant's rights were dependent upon its tax-exempt status showed the likelihood that the for-profit corporations were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether it benefited substantially from the operation of the applicant. The court determined that there was a substantial private benefit because the applicant "was simply the instrument to subsidize the for-profit corporations and not *vice versa* and had no life independent of those corporations."

In P.L.L. Scholarship v. Commissioner, 82 T.C. 196 (1984), an organization operated bingo at a bar for the avowed purpose of raising money for scholarships. The board included the bar owners, the bar's accountant, also a director of the bar, as well as two players. The board was self-perpetuating. The court reasoned that, because the bar owners controlled the organization and appointed the organization's directors, the activities of the organization could be used to the advantage of the bar owners. The organization claimed that it was independent because there was separate accounting and no payments were going to the bar. The court was not persuaded.

A realistic look at the operations of these two entities, however, shows that the activities of the taxpayer and the Pastime Lounge were so interrelated as to be functionally inseparable. Separate accountings of receipts and disbursements do not change that fact.

The court went on to conclude that, because the record did not show that the organization was operated for exempt purposes, but rather indicates that it benefited private interests, exemption was properly denied.

In Church By Mail, Inc. v. Commissioner, T.C. Memo 1984-349, *aff'd* 765 F. 2d 1387 (9th Cir. 1985) the tax court found that a church was operated with a substantial purpose of providing a market for an advertising and mailing company owned by the same people who controlled the church. The church argued that the contracts between the two were reasonable, but the Court of Appeals pointed out that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church."

In St. Louis Science Fiction Limited v. Commissioner, T. C. Memo 1985-162, April 2, 1985, the Court reviewed the annual convention of a science fiction organization. It held that while the conventions may have provided some educational benefit to some of the individuals involved, that social and recreational purposes, and private benefit predominated. The Court distinguished Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980) in which the organization provided public art education by using juries to insure artistic quality and integrity.

In Easter House v. United States, 846 F. 2d 78 (Fed. Cir. 1988), aff'g 12 Cl.Ct. 476 (1987), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because a substantial purpose of the adoption activity was a non-exempt commercial purpose. It found that the adoption services did not further the exempt purposes of providing educational and charitable services to the unwed mothers and children. Rather, the services for unwed mothers and children were merely provided "incident" to the organization's adoption service business. Moreover, the court found that "adoption services do not in and of themselves constitute an exempt purpose."

The court also agreed with the IRS' determination that the agency operated in a manner not "distinguishable from a commercial adoption agency" because it lacked the following traditional attributes of a charity. First, the agency's operation made substantial profits, and there was a substantial accumulation of capital surplus in comparison to direct expenditures by the agency for charitable and educational purposes. Second, the agency's operation was funded completely by substantial fixed fees charged adoptive parents. It relied entirely on those fees and sought no funds from federal, state or local sources, nor engaged in fund raising programs, nor did it solicit contributions. In fact, the agency had no plans, nor intention to seek contributions, government grants or engage in fund raising relative to its operations. Third, the fixed fees the agency charged adoptive parents were not subject to downward adjustment to meet potential adoptive parents' income or ability to pay. Fourth, the agency's single life member had near total control of the operations of the agency. And fifth, the agency functioned by means of a paid staff of 15 to 20 persons, with no volunteer help.

In addition to furthering a substantial non-exempt purpose, the court found that a portion of the organization's net earnings inured to the benefit of a private shareholder or individual as defined by sections 1.501(c)(3)-1(c)(2) and 1.501(a)-1(c) of the regulations. The organization provided a source of credit (i.e. loans) to companies in which the private shareholder was either employed by or owned. The fact that the loans were made showed that the companies controlled by the private shareholder had a "source of loan credit" in the organization.

In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36, the court found an organization that ran tours aimed at doctors and their families was operated to benefit the private interests of both an individual who controlled the organization and a for-profit travel agency (H&C Tours) that handled all of its tour arrangements.

The organization used the H&C Tours exclusively for all travel arrangements. There was no evidence that the organization solicited competitive bids from any travel agency for travel arrangements for its tours other than H&C Tours. The organization physically located its office within the offices of H&C Tours, which provided it secretarial, clerical, and administrative personnel for a fee equal to H&C Tours' costs. The organization spent 90 percent of its revenue on travel brochures prepared to solicit customers for tours arranged by the travel agency. The

brochures emphasized the sightseeing and recreational component of the tours, but did not describe the medical curriculum for the seminars and symposia that was the basis for exemption. Educational activities occurred on less than one-half of the days on a typical tour.

The court found that a substantial purpose of the organization's operations was to increase the income of H&C Tours. The president of H&C Tours controlled the organization and exercised that control for the benefit of H&C Tours and himself. Moreover, the administrative record supported the finding that the organization was formed to obtain customers for H&C Tours.

The court in Redlands Surgical Services v. Commissioner, 113 T.C. 47 (1999) stated that merely entering a partnership with private parties in which they receive a return on a capital investment does not impermissibly confer private benefit. However, a detailed examination of the Redlands surgery center venture convinced the court that the petitioner had ceded control to private parties having an independent economic interest in the activity and no obligation to promote charitable purposes ahead of profit making. Therefore, the applicant was not operated exclusively for exempt purposes. The Court pointed to the long-term management contract with a party related to the for-profit, with broad discretion, and a fee based upon gross revenue. Furthermore, the record did not show that the nonprofit had any role in negotiating the contract, and that it was executed for both parties by the same individual, indicating self-dealing. Nor did the record show that the petitioner had any informal control: as it did not have the resources or the ability to oversee the operations.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court concluded that the Foundation was operated with a substantial non-exempt purpose. It based this conclusion on the manner in which the organization managed a conference center. "Among the major factors courts have considered in assessing commerciality are competition with for-profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, *inter alia*, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations." Thus, the court looked at the business methods of the organization as a method of inferring whether its purpose was to serve the public or whether there was a substantial non-exempt purpose of operating a business for profit. See section 1.501(c)(3)-1(e), Income Tax Regulations.

The Credit Repair Organizations Act ("CROA"), 15 U.S.C. section 1679 *et seq.*, effective April 1, 1997, imposes restrictions on credit repair organizations, including forbidding the making of untrue or misleading statements and forbidding advance payment, before services are fully performed. 15 U.S.C. section 1679b. Section 501(c)(3) organizations are excluded from regulation under the CROA. The CROA defines a credit repair organization as:

- (A) any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of—
 - (i) improving any consumer's credit record, credit history, or credit rating, or

(ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

15 U.S.C. section 1679a(3). The courts have interpreted this definition broadly to apply to credit counseling agencies. The Federal Trade Commission's policy is that if an entity communicates with consumers in any way about the consumers' credit situation, it is providing a service covered by the CROA. In Re National Credit Management Group, LLC, 21 F. Supp. 2d 424, 458 (N.D.N.J. 1998).

16 C.F.R. section 310.4(b)(1)(iii)(B); 47 C.F.R. section 64.1200(c)(2) prohibits businesses from cold-calling consumers who have put their phone numbers on the National Do-Not-Call Registry, which is maintained by the Federal Trade Commission ("FTC"). Nonprofit organizations are not subject to this rule. This registry was created by rules promulgated by the FTC and the Federal Communications Commission.

3. Analysis

Based on your submission, we cannot conclude that you are properly organized and operated under section 501(c)(3) of the Code. Your articles of incorporation are defective. Furthermore, the information in the file shows you do not operate for an exempt purpose, but rather in a commercial manner for a significant non-exempt purpose and to provide private benefit to a related for-profit enterprise, its shareholders, and to the credit card companies to whom your clients owe money. In addition, your income inures to your founders directly and through because they would be prohibited from conducting this business directly and because your income is being used to pay off their personal debt in creating

Organizational Test

Section 1.501(c)(3)-1(b)(1)(i) of the regulations explains that an entity will only be considered to be organized exclusively for one or more exempt purposes if its Articles of Incorporation limit its purposes to one or more purposes listed as exempt in section 501(c)(3). Your articles state that you are organized to provide credit counseling. Credit counseling is not an inherently exempt purpose under section 501(c)(3) and can be conducted in a manner that furthers nonexempt purposes. Nothing in your Articles of Incorporation restricts you to conduct your credit counseling activities in a manner that will exclusively further charitable, educational or other exempt purposes. Therefore, you are not properly organized under the Code.

Operational Test

Operation for a Charitable or Educational Purpose

You are also required to show that you operate exclusively for exempt purposes. Section 1.501(c)(3)-1(c)(1) of the regulations explains that an organization will be regarded as operating exclusively for exempt purposes only if it engages primarily in activities that accomplish one or more of the exempt purposes specified in Section 501(c)(3) of the Code. Performing activities exclusively for the benefit of the poor will further a charitable purpose. Counseling the poor about economics and personal finance can achieve an exempt purpose. See Rev. Rul. 69-441,

supra. However, you admit that you do not limit your services to the poor and distressed or underprivileged through a financial test or income limit for those who may engage your services. Therefore, you do not operate to further a charitable purpose in the sense of providing relief to the poor or distressed.

Another enumerated exempt purpose that might describe your activities is education. Training an individual to develop his capabilities or instructing the public on subjects useful to the individual and beneficial to the community are both educational purposes, recognized as exempt. See section 1.501(c)(3)-1(d)(3) of the regulations. Financial counseling could be carried out as an educational activity. Consumer Credit Counseling Service of Alabama, Inc. v. United States, Rev. Rul. 69-441, *supra*. While education is a very broad concept, the Service and the Courts require that some rigor must be evident. St. Louis Science Fiction Limited, *supra*.

You have not demonstrated that the service you provide is educational in the sense recognized by the law. A review of your activities discloses no institutional support for education. The presentation and web site material you submitted is superficial and inadequate to provide financial education. You have not submitted any evidence of plans for future educational activity, and have neither hired competent employees to perform education, nor budgeted to provide it. Your board of directors has no experience in educational methods, and there is no evidence that it plans to acquire any expertise.

Your activities are completely different from those found to be educational by the court in Consumer Credit Counseling Service of Alabama, Inc. v. United States and by the Service in Rev. Rul. 69-441, *supra*. Those organizations were primarily engaged in providing community education and individual education through counseling, according to the Court opinion. Most of their time was spent providing information to the general public through speakers, films, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit. Additional time was spent in individual counseling concerning budgeting and the appropriate use of consumer credit to "debt-distressed" individuals and families. Only 12 percent of the time of the professional counselors at the agency was used in debt management programs.

On the other hand, you have shown almost no activity providing general education for the community. You claim to have conducted a single public seminar at a _____ since your formation. However, you have not provided a copy of the agenda followed or the materials used in the seminar as was requested, nor have you offered any other information to demonstrate that the seminar had any educational value. Furthermore, the _____ was addressed to _____ and not to you, indicating that credit for undertaking the seminar, such as it was, belongs to _____ and not to _____.

The material posted on your website, _____ is either very general and inspirational, or promotes your debt management plan (DMP). It does not provide readers with useful information about credit-related topics, such as how credit is established or impaired, how credit reports are maintained, or how individuals can protect or improve their credit through budgeting, financial planning, and other conscientious measures. It does not help individuals or the public at large to enhance their knowledge or improve their skills. Under the applicable legal standards, the content of the web site does not qualify as public education.

You have not demonstrated that your "counseling" sessions with your clients have any educational content. You have not established that the counselors, whose services are contracted from _____ have the training or background necessary to provide meaningful education. You require your counselors to have only a high school diploma and some experience in the credit counseling industry. However, the experience could be data entry or some other marketing or administrative task that does not qualify the person to educate debt-distressed individuals. While you have provided copies of training certificates earned by your counselors, you have not provided the credentials of the institution, nor any information about the depth or length of the curriculum that was presented or the knowledge or skills that had to be mastered to earn the certificate.

The service that you provide to individuals appears to be entirely devoted to marketing the benefits of your debt management plans. It is clear from the amount of time that your employees spend on calls and the training materials they use that they cannot be conducting significant individual training. Your employees make up to _____ calls per hour when first contacting the names on the purchased lists. Thus, initial calls last approximately _____ minutes. You maintain that when a counselor is enrolling a potential client in a DMP or reviewing budget information, the calls are longer, an average of _____ calls per hour, or _____ minutes per call. However, the Counselor Training Manual that you submitted only explains how to administer a debt management plan. It explains how to answer clients' questions about why creditors are still calling, how to ascertain the status of the client's account, and how to explain why the client cannot speak with the person who initially enrolled him in the program. In effect, it is a customer service guide to be used with individuals who have questions about the DMP they have purchased. It does not explain how a counselor should educate the caller about personal finance, responsible buying practices, or even a general understanding of consumer credit. You also maintain that it generally requires about 15 to 20 minutes to gather the necessary information from a client once a counselor has made the determination that the DMP would be beneficial. You do not claim that this time is educational, or spent explaining the intricacies of consumer credit. This longest phone call is used to relate and verify the detailed information on credit card accounts, addresses, amounts due, etc that are used to set up the DMP.

In addition, you represent that you provide counseling to individuals who do not qualify, are not interested in, or are exploring other options along with a DMP, at no cost. You maintain that, in approximately _____ to _____ percent of the cases, a counselor is working with a person who does not enroll in the program, with the remainder enrolling in a DMP. The number of leads purchased by _____ and sold to you to date is approximately _____ and the number of contacts who signed up for your DMP to date is approximately _____. However, speaking with the contacts or leads to determine whether they are interested in purchasing a DMP is not counseling or education. You have not demonstrated that you speak with individuals (whether they call you initially or you call them from a list of leads) in any systematic or substantive way about any subject other than DMPs and their potential eligibility. The conversations serve as merely part of your efforts to sell DMPs. You purchase leads and your counselors work with these leads to convince people to purchase DMP services. You operate in a manner indistinguishable from that of a commercial phone solicitor.

Furthermore, the compensation system for the counselors rewards them for selling DMPs, not for the quantity or quality of any education they might provide. The pay structure signals

that they are expected to use their time to maximize the number of DMP sales. Purely educational activities, particularly education provided to an individual who has declined to purchase a DMP, would run contrary to the counselor's personal incentives.

Thus, we cannot conclude that you convey any meaningful information or skills instruction to the individuals you claim to counsel or to the public at large. A single seminar with no established content, and a high volume of short telephone calls made by employees who are trained to sell DMPs and provided financial incentives to provide DMPs, but have neither training, nor incentive, nor opportunity to educate the individuals they call does not evidence an educational purpose.

Operation for Private Benefit

Even if you had an exempt purpose, you would still have to show that you benefit the general public rather than the private interests of a select few. Section 1.501(c)(3)(1)(d)(1)(ii) of the regulations provides that private interests are those such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by them. Private individuals may receive incidental benefits that are a necessary concomitant to achieving an exempt purpose, for example doctors paid to treat patients. However, the benefits you provide to the private interests of I

and the credit card companies to whom your clients owe money are not incidental, but actually prevent you from achieving an exempt purpose.

Control is an important factor in determining whether an organization operates for the benefit of private interests. You are controlled by a small, self-perpetuating Board of Directors that you share with your for-profit service provider. This is in contrast to directors drawn from a broad community that controlled the credit agencies analyzed in Consumer Credit Counseling Service of Alabama, Inc. v. United States and Rev. Rul. 69-441, *supra*. When private individuals or for-profit entities have either formal or effective control of a non-profit organization, it raises questions concerning whether the organization furthers the profit-seeking motivations of those private individuals or entities. See Redlands, *supra*. of your board members are key employees of and are working full-time for the business. Each of your board members is a shareholder of , and there are no other shareholders.

You have ceded control over your business to the for-profit management company, You chose to manage your business and administrative affairs without soliciting competitive bids from any other company. Your negotiation with cannot be described as arm's-length, because its owners and officers also control you. Your contract with reveals the manipulation of your role for the benefit of . The contract does not contain any terms or conditions that ensure will pay fair market prices for goods or services, and there are no independent board members at who can monitor the prices is paying or the quality of services it is receiving. As a result, is able to promote its services through you, at prices that serve the private interests of its owners (who are your board members), and in a manner that furthers its private business interests.

As in est of Hawaii, *supra*, you are totally dependent upon one for-profit company for all of your operations. It provides employees, offices, equipment, and services. If you terminated the

management agreement, you would cease to function. Although you do not have the long-term management agreement that the Court objected to in Redlands, *supra*, the effect of ceding all control to effectively converts it into a perpetual contract. As the court pointed out in Redlands, you have no ability to oversee the contract because you have no independent employees or resources.

Your status as an exempt organization provides legal benefits to your for-profit affiliate, allowing it to circumvent rules promulgated by the Federal Trade Commission (i.e. The Credit Repair Organization Act and the National Do-Not-Call List). Exempt organizations are not subject to the Do-Not-Call List, so may call the hundreds of thousands of families that have attempted to shield themselves from telemarketers. CROA forbids any person from making misleading statements, or requiring advance payment in connection with credit repair, but organizations recognized under section 501(c)(3) are exempt from its regulations.

The terms of your agreement with your clients makes it clear that you are not operating for their benefit. The client must agree that his first monthly payment (based upon the amount he owes to creditors) will not be disbursed to the creditors. You will retain it. If the client stays in your program for the full three to five years that it often takes to pay off credit card debt, he will receive the processing fee portion of this money back. However, at the beginning of the program, you exacerbate his problem because his creditors miss an entire month's payment. This generates such predictable questions from your clients that you have to tell your counselors what to say to clients who continue to receive calls from creditors, as referenced in your Counselor Training Manual. In addition, you have the use of the funds for many years, or permanently if the client for any reason cannot complete the program. The client agreement even advises the client that you operate in part for the benefit of his creditors. You are unlike the organization in Rev. Rul. 69-441 because the ruling specifically states that all of the clients' money was applied to pay their debts.

As discussed above, the general public does not benefit from your relationship with The individuals who do derive significant benefits are the shareholders and creditors of The financial interest that your board has in the for-profit affiliate presents an avenue for private benefit to the entity. The shareholders invested \$ in with the understanding that the organization will repurchase the stock at a price reflecting the amount of profit earned. Thus, if your operations do contribute to the profitability of in the ways discussed above, or in other ways, the shareholders of will directly benefit. of the shareholders also extended a line of credit to in the amount of \$. The shareholders control the interest rate and the rate of repayment of the principal of this loan. It appears that this is the loan referred to in your budget for that contains a line item for \$ for "loan repayment." However, if this is the case, it means that you are repaying a loan by your directors to a for-profit entity. This action constitutes private benefit.

The credit card companies to whom your clients owe money also receive private benefit from your operations. In fact, it can be measured by the amount of the "fair share" payments that the companies pay you to collect money for them. This is clearly a business relationship for which you are paid that does not produce any public benefit. This distinguishes you from the organizations in Consumer Credit Counseling Service of Alabama, *supra*, which received the bulk of their support from government, private foundations, contributions, labor agencies, and the

In sum, the structure of your organization and its close relationship to , the absence of independent board members to monitor quality, the lack of terms and conditions restricting the payments to to arm's length standards, and the clear business benefits of having a nonprofit organization claiming to be the party contacting clients combine to support the conclusion that you are operated for the private benefit of and its shareholders and not for the interest of the public at large or any charitable class of individuals.

Substantial Nonexempt Purpose

Only an insubstantial portion of the activity of an exempt organization may further a non-exempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, *supra*, the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if we agreed that you were organized and operated for an exempt purpose, the fact that you also have a substantial non-exempt purpose would be sufficient to deny recognition to you. Specifically, the court in Better Business Bureau held that if education is conducted for a non-exempt purpose, the organization will not be recognized as exempt. Based on the information in the file, it appears that you operate in a commercial manner for the substantial, non-exempt purpose of furthering the business of

You conduct your operations in a manner that is consistent with a commercial firm seeking to maximize sales of services, rather than in the manner that would be consistent with a charitable or educational organization seeking to serve a charitable class or the public at large. Thus, the way in which you go about your credit counseling activities indicates that you are operating for the purpose of providing customers for services.

First, you lack the public support and public control that are characteristic of a charitable organization seeking to serve the public. You are not supported by contributions from the general public, government or private foundation grants, or assistance from the with only an incidental part of your revenue from counseling fees, as were the credit counseling agencies in Consumer Counseling Service of Alabama, and Credit Counseling Centers of Oklahoma, *supra*. In fact, you do not even have a fundraising program to solicit such contributions. According to your proposed budgets for and you plan to receive all your revenue from fees from setting up client's DMPs, monthly contributions, and fair share from creditors. You are similar to the organization described in B.S.W. Group, *supra*, in which the court cited lack of solicitation and sole support from fees as factors disfavoring exemption.

In addition to your lack of public financial support, your organization shows none of the public involvement that characterizes organizations serving a public interest. Your activities are carried out exclusively by paid contractors rather than by volunteers. Your small Board of Directors is related by family and is not representative of the community. The same directors also serve as your officers. Moreover, you share the same board members and officers with those of a for-profit entity with which you do business. In fact, your board members are shareholders of and lenders to You are unlike the organization described in Rev. Rul. 69-441, *supra*, in which the organization's Board of Directors is comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions. You find your clients from leads that you purchase whereas the organizations described in Rev.

Rul. 69-441 and Consumer Counseling Service of Alabama, Inc. v. United States, supra, and Credit Counseling Centers of Oklahoma, Inc. v. United States, supra, were viewed as a public resource, as shown by the fact that community groups, members of the clergy, labor unions and the like referred clients to them.

Other aspects of your operation are very similar to that of the organization discussed in Easter House v. United States, supra. That organization made substantial profits, and accumulated a substantial amount of capital surplus in comparison to direct expenditures for charitable and educational purposes. In your proposed budget for _____, you plan to accumulate \$ _____ in net profits, while in _____ you expect to earn \$ _____ in net profits. You plan to contribute only _____ percent of those net profits to other charitable organizations and have provided no budget or evidence to show that the rest of the net profits will be used for any activity, let alone any charitable or educational activity, rather than perpetuating the call solicitations that generate DMP purchases. In fact, you plan to spend over \$ _____ on advertising in _____.

Like Easter House, you function by means of a paid staff with no volunteer help. You have a total of _____ workers who provide support and client services. Each of the workers is an employee of _____. Each is paid a base salary with a commission that is measured by the number of clients who enroll in the program along with the level of services provided (measured through DMP retention). Each counselor receives a bonus based on the entire group's performance in this format. An exclusively paid staff and a bonus structure of this type are characteristic of a commercial corporation, rather than a charitable non-profit organization.

Another distinction between commercial operations and businesses run for charitable purposes is the level of fees charged. You have not provided any evidence that the processing fee of _____ percent of annual payments has any relationship to the cost of the processing, much less is below cost or are even below the rates that a commercial credit counseling agency would charge. Recently, the judge in Airlie Foundation, supra, analyzed the organization's fee structure and found that it failed to operate exclusively for exempt purposes because it did not provide its conference center services substantially below cost, and only provided reduced rates for some exempt organization clients. A comparable conclusion can be drawn about your services as you have failed to establish that your fees are below cost. The requirement of a fee for each service that is at or above cost, when charged for a service that does not inherently further a charitable or educational purpose may cause the organization to violate the operational test. See B.S.W. Group, Inc. v. Commissioner, supra. The credit counseling organizations described in Consumer Counseling Service of Alabama, Inc. v. United States, supra, and Credit Counseling Centers of Oklahoma, Inc. v. United States, supra, received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental part of their revenue was from counseling fees.

Your relationship to _____ suggests that you operate to further its business. Like the organizations in Church by Mail, and est of Hawaii, supra, you have chosen without any competition one corporation to manage every aspect of your business. As the court held in Church by Mail, the critical inquiry is not whether the terms of your contract with _____ are reasonable, but whether the whole enterprise is carried out in such a way that the for-profit benefits substantially.

Moreover, calling names on a list that you have purchased because it may contain some people to whom you can sell your services is effectively "prospecting," what was a typical part of the telemarketing process until the FTC's Do-Not-Call List reduced the number of homes that such sales people could call. Exempt organizations are not subject to the restrictions of the Do Not Call List. Thus, would be restricted from calling all of those who have registered on the List, but you are not. The extensive use of the purchased leads under these circumstances indicates that furthering business interests is a substantial purpose of your operations.

Inurement

An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) defines the words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization. (See section 1.501(c)(3)-1(c)(2) of the regulations.)

Like the organizations in Church By Mail, est of Hawaii, International Postgraduate Medical Foundation, and P.L.L. Scholarship, you transfer all of your business contacts to a related for-profit entity. The related entity then completes the business transaction and realizes the profit. But you have gone even further than that. can only operate its business because your exempt status allow it to avoid regulation under CROA and the Do Not Call List that would shutter its doors. You can make thousands of calls to individuals who have not previously contacted you, that would be forbidden to your affiliate and conduct activity that would otherwise be forbidden as credit repair. The Court in est of Hawaii, was particularly offended that the for-profit entity was "trading on" the tax-exempt status of the applicant.

You have represented that provides with all employees, office space, office equipment, computer hardware and software, and all the necessary expertise to conduct its business. The Management Agreement between and states that all these services are provided at "actual cost." The contract lacks the indicia of a standard arm's-length commercial contract: there is no limit on the amount that can charge Nor are there any mechanisms for to dispute the amount of such costs. The officers and directors of the two organizations are identical.

Under certain situations, your Shareholders' Agreement may also result in inurement. Your directors have invested \$ in operating capital needed to start , in the following percentages, percent), percent), and percent). In addition, and agreed to extend a line of credit to in the total amount of \$_. As a result, your directors and officers (i.e. insiders) have a substantial financial interest in and will personally benefit at your expense. The officers and directors are not paid a fixed salary by Instead, the Shareholders' Agreement enables the officers and directors of to exercise redemptions of stock, the price to be calculated using factors for net profits and years of operation. This suggests that the earnings of which are largely to be paid over as expenses without cap or review to under the vague terms of the Management Agreement, may inure to the benefit of insiders.

On your proposed budgets for and one of your expenses is a "loan repayment." It appears that you are repaying the loan to that was provided by your directors who are also shareholders. If so, a portion of your net earnings is inuring to the benefit of the shareholders of This is similar to the situation in Easter House v. United States, *supra*, in which the organization provided a source of credit (i.e. loans) to companies in which the organization's private shareholder or individual (as defined by sections 1.501(c)(3)-1(c)(2) and 1.501(a)-1(c)) was either employed by or owned. The fact that the loans were made shows that the companies controlled by the private shareholder had a "source of loan credit" in the organization. Although in your situation it appears you are paying off a loan rather than making one, the economic effect is the same and the inurement rule is violated.

benefits from the terms of its one-sided management agreement with you. The shareholders of can extract the profit to which you contribute through stock redemption agreements. In addition, of them control the terms of repayment of a loan that they made to Consequently, there are multiple possibilities for inurement of the earnings of to and its officers and directors, and you have failed to explain how earnings will be safeguarded from inurement.

Conclusion

Based on the review of your actual and proposed activities in light of the applicable law, we find that you are not organized nor are you operated for exempt purposes. Your principal activity is the marketing of debt management plans. This activity does not achieve charitable or educational purposes, but is merely a commercial service. Even if you were able to establish that you were formed and operated for charitable or educational purposes, you would not qualify for exemption because you are operated for a substantial non-exempt purpose. Your contractual relationship with leaves you helpless to run your program for charitable purposes. You cannot set your own fees, you cannot hire and supervise your own employees, and you cannot service your own clients. You function solely as an intake department for You provide both private benefit and inurement to credit card companies, and your officers and directors.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
SE:T:EO:RA:T:2

1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Marvin Friedlander
Acting Manager
Exempt Organizations
Technical Group 2